

March 19, 2013

The Honorable David Reichert
United States House of Representatives
1127 Longworth House Office Building
Washington, DC 20515

The Honorable John Lewis
United State House of Representatives
343 Cannon House Office Building
Washington, DC 20515

Dear Reps. Reichert and Lewis

Farm Bureau supports replacing the current federal income tax with a fair and equitable tax system that encourages success, savings, investment and entrepreneurship. We believe that the new code should be simple, transparent, revenue neutral and fair to agricultural producers.

We commend the Ways and Means Committee on its methodical approach to tax reform by forming working groups to review current law and to compile feedback from stakeholders, academics and think tanks, practitioners, the general public and elected representatives. We offer the following comments on charitable contributions and the Unrelated Business Income Tax (UBIT) to you as the chair and co-chair of the charitable/exempt organizations working group.

Charitable Contributions

Farm Bureau supports a deduction for charitable contributions. Our members believe that charities play a valuable role in providing services to those in need in our communities and that people in need will be harmed the most if charitable giving is curtailed. Studies indicate that donors give for many reasons. While Americans do not make charitable gifts only for tax reasons, tax incentives make more and larger gifts possible. This is true for two tax provisions of special interest to farmers and ranchers that are set to expire at the end of this year.

The first provision of interest in the tax deduction for food donated to soup kitchens, food banks and other feeding organizations. Despite the wealth of our country, affordable food prices and ongoing government food assistance programs, some people still have difficulty purchasing food for a proper diet.

Some farmers and ranchers already donate gleaned food to charity. Many more would do so if they were able to bear the costs of harvesting, processing and transporting surplus food. Unfortunately, when growers can't afford the expense of getting food from the field to the food bank, all too often it is left to rot in the field or orchard. Farm Bureau believes the charitable deduction that allows non-C corporations to take a deduction for donating food should be made permanent and the deduction should be expanded so that farmers who use cash basis accounting could also take advantage of the deduction.

The second tax deduction of particular interest to farmers and ranchers is the enhanced deduction for donating conservation easements to preserve farmland. The current deduction has been temporarily expanded to raise the maximum deduction a donor can take for donating a conservation easement and to increase the number of years over which the deduction can be taken. More farmland owners would be willing to protect their farmland from development if the deduction is made permanent and if they are able to take a deduction akin to the reduced value of their property.

Unrelated Business Income Tax (UBIT)

Many associations receive favored tax treatment in recognition of the public benefits derived from satisfying their tax exempt purpose. Farmers and ranchers formed the American Farm Bureau Federation in 1919 so they could work together, speak in a unified voice and, as a group, achieve what individuals could not. Today Farm Bureau is an independent, non-governmental, voluntary organization that works for the betterment of farms and ranches under 501(c)5 of the federal income tax code.

In addition to performing their stated missions, Farm Bureau and other associations contribute substantially to national, state and local economies across the nation. Among the taxes associations pay are federal payroll (Social Security, Medicare, and unemployment) taxes, state and local unemployment taxes, real estate taxes, sales and use taxes, franchise taxes and unrelated business income taxes (UBIT).

In general, exempt organizations pay UBIT on income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions. Interest, rents, royalties and annuities (i.e., payments of passive income) are generally received free of tax by exempt organizations. Under Internal Revenue Code Section 512(b)(13), however, these payments are subject to tax if they are received from a controlled organization (e.g., a subsidiary).

Prior to the enactment of the Taxpayer Relief Act of 1997 (TRA 97), an organization was considered controlled if the exempt organization had a direct or indirect ownership interest of 80 percent or more in that organization. TRA 97 changed the ownership percentage to 50 percent. According to TRA 97 Committee Reports, the reason for automatically taxing income from a controlled organization was to prevent subsidiaries of tax-exempt organizations from reducing otherwise taxable income by borrowing, leasing or licensing assets from a tax-exempt parent organization at inflated levels.

Section 1205 of the Pension Protection Act of 2006 modified TRA 97 to provide that interest, rents, royalties and annuities received by an exempt organization from a controlled organization would only be taxed when the payment exceeds fair market value for 2006 and 2007. This provision has subsequently been extended three times and remains in place through 2013. A 20 percent penalty is imposed on excessive payments. Tax-exempt organizations that receive interest, rent, annuity or royalty payments from a controlled organization must report payments on informational tax returns. The change to Section 1205 only applies to payments made under binding written contracts (or their renewals under substantially similar terms) in effect on the date of enactment.

Section 1205 corrected an anomaly in TRA 97 which resulted in exempt organizations becoming liable for Unrelated Business Income Tax (UBIT) on payments of passive income, even when they reflect fair market amounts. For example, many exempt organizations receive rents at an arms length amount from taxable subsidiaries that were established and operate for non-abusive purposes. Under TRA 97 these exempt organizations were subject to tax, even though their receipt of rents from unrelated organizations under the exact same terms would not be subject to tax.

The fair market provisions of Section 1205 of the Pension Protection Act of 2006 should be made permanent and should be amended to cover new, as well as existing, contracts between tax-exempt parent organizations and their controlled subsidiary organizations. Otherwise, the anomaly described above will exist under new contracts not covered by the statute. If it makes sense to apply the well established principles of Section 1205 for one or two years at a time, there is every reason to do so permanently. In so doing, Congress will also prevent the long-term uncertainty that Section 1205 creates for many exempt organizations.

Farm Bureau thanks you for your consideration of our views on Charitable/Exempt Organizations tax policy. We would be glad to meet with you to provide additional information or to discuss our positions in greater detail.

Sincerely,

A handwritten signature in black ink, appearing to read 'Bob Stallman', with a long horizontal flourish extending to the right.

Bob Stallman
President